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Yen Creeps Back Up

Subtle discipline is sometimes the most effective way to exert one's will on a child -- or foreign exchange markets. Although some child psychologists and experts in international finance might dispute such a conclusion, finance ministers and central bankers of the Group of Seven industrial nations might be among the believers in the aftermath of a May 6 meeting in Washington. In contrast to an apparently contentious April meeting, after which the yen moved little against the dollar, the quieter May session led to a long-awaited surge in the value of the Japanese currency.

At the earlier G-7 meeting Finance Minister Ryutaro Hashimoto reportedly carried an urgent message to his counterparts: the yen was in trouble along with the Japanese stock market (see JEI Report No. 15B, April 13, 1990). At the time the Japanese currency was trading at its lowest level in more than three years, and the stock market uncharacteristically had been dropping for three months. While the subsequent communique mentioned the undesirability of a weak yen, most press reports suggested Mr. Hashimoto's colleagues generally turned a deaf ear to his plea for support. The meeting followed repeated but mostly

apparently soothed the European feathers ruffled as the IMF struggled to make room for Japan near the top of the list.

With the latest reshuffling the United States and Japan dominate the top ranks of contributors to both the IMF and its sister institution, the World Bank. An American traditionally heads the World Bank and a European, the IMF. The next debate over relative influence in the two organizations could coincide with the 1992 expiration of the term of the current IMF managing director, Michel Camdessus of France. Some reports suggest that Tokyo would like a Japanese national to replace Mr. Camdessus, a move that would appear to be a logical extension of the latest quota allocation. European nations, feeling a burst of regional pride as a result of their expected 1992 economic integration and the worldwide focus on Eastern Europe, are not likely to be enthusiastic about such an initiative. In the long run imposing discipline on the yen and other currencies is likely to be child's play compared to curbing the sibling rivalry among the leading industrial countries.

Douglas Ostrom

Washington Ups Ante In Financial Talks

In a bid to stave off congressional retaliation the Bush administration pushed hard for broader liberalization of Japan's financial markets during a May 21-22 meeting in Tokyo of the U.S.-Japan Working Group on Financial Markets. In essence, Under Secretary of the Treasury for International Affairs David Mulford urged Tokyo to adopt a hands-off attitude toward domestic financial markets, letting the forces of supply and demand reshape market structures and allowing foreign firms to freely peddle innovative products in Japan. The Japanese delegation, led by Vice Finance Minister for International Affairs Makoto Utsumi, was prepared with responses to the numerous American suggestions but made it clear that liberalization will proceed in a careful and gradual manner. The agenda of the two-day meeting covered four broad areas:

- Deregulation of deposit interest rates - The Bush administration recognizes that the Ministry of Finance has taken important steps toward deregulating interest rates paid on deposits but wants the process to be accelerated and a definite timetable set for complete deregulation. The Finance Ministry pointed out that a majority of savings deposited with banks is already in free-market instruments (see Table). Nevertheless, MOF hinted at a tentative schedule for deregulating by 1993 interest rates paid on all time deposits. The Ministry has a three-pronged plan of attack: lowering the minimum amount for large-lot time deposits, which offer freely changing market returns; lowering the minimum size of small-lot money market certificates, which offer a fixed rate of return linked to market rates; and introducing a new instrument this fall that will offer a return indexed to market rates but capped at some level. MOF is facing stiff opposition to the introduction of the new type of money market certificate from small regional banks and credit associations that fear it will put severe pressure on their profit margins. Not only is the cost of raising funds higher but the cost of administering deregulated instruments is higher than for fixed-rate time deposits. The interest rate cap is a concession to these smaller institutions, but MOF is determined to expose all Japanese deposit takers to the discipline of market forces.

Trends in Market-Rate Bank Deposits in Japan

(in billions of yen and percentage share)

		Market-Rate Deposits						
	Total Deposits*	Large Time Deposits	Money Market Certificates	Non-Residents' Yen Deposits	Foreign Currency Deposits	Certificates of Deposit	Total	Market-Rate to Total Deposits
1975	¥92,921.3	--	--	[¥2,591.7] 100.0%		--	¥2,591.7 100.0%	2.8%
1980	152,978.3	--	--	1,137.9 11.8%	6,577.0 68.2%	1,931.1 20.0%	9,646.0 100.0%	6.3
1981	171,418.5	--	--	1,260.0 10.7%	7,863.0 66.7%	2,674.0 22.7%	11,797.0 100.0%	6.9
1982	183,576.8	--	--	1,337.0 9.6%	8,953.1 64.5%	3,581.1 25.8%	13,871.2 100.0%	7.6
1983	199,507.9	--	--	1,349.3 7.7%	11,622.8 66.1%	4,612.4 26.2%	17,584.5 100.0%	8.8
1984	218,242.0	--	--	1,987.9 8.6%	13,934.4 60.2%	7,210.7 31.2%	23,133.0 100.0%	10.6
1985	238,581.5	¥4,598.4 12.1%	¥5,095.5 13.4%	2,413.7 6.3%	18,021.5 47.3%	7,979.6 20.9%	38,108.7 100.0%	16.0
1986	258,948.5	16,267.4 30.5%	8,028.6 15.1%	1,783.6 3.3%	18,744.3 35.2%	8,445.8 15.9%	53,269.7 100.0%	20.6
1987	284,623.3	43,515.2 47.0%	15,113.4 16.3%	2,018.2 2.2%	22,877.4 24.7%	9,151.4 9.9%	92,675.6 100.0%	32.6
1988	358,337.8	80,367.6 54.6%	26,145.4 17.8%	2,103.7 1.4%	23,213.6 15.6%	15,368.6 10.4%	147,198.9 100.0%	41.1
1989	405,502.3	152,628.7 66.0%	30,521.9 13.2%	2,100.5 0.9	25,608.7 11.1%	20,393.3 8.8%	231,253.1 100.0%	57.0

*Deposits from all sources plus certificates of deposit.

Source: Bank of Japan

A particularly thorny problem, however, is how to deregulate rates paid by the giant postal savings system. If the rates are competitive with those offered by the nationwide commercial city banks, the postal savings network would overwhelm small, local banking institutions; if they are restricted to preserve these operations, the postal savings system will be uncompetitive in areas where the nationwide and regional banks operate. Bankers want some limits on the postal system since it is, in some ways, larger than their entire industry. As an example of its competitive ability the postal savings network recorded about Y4 trillion ($26.7 billion at Y150=$1.00) worth of new small-lot MMCs on April 2 when a lower minimum size went into effect, dwarfing the amount registered by its nearest competitor, Sumitomo Bank, Ltd.'s Y86 billion ($573.3 million).

- Foreign access to Japanese financial markets - The U.S. negotiating team attacked the various legal and administrative partitions that prevent foreign financial firms from freely participating in whichever Japanese market they may desire. The American side argued that interbank markets (particularly the interbank brokerage or tanshi market), specialized banking markets, such as trust and pension fund management, and Japanese equity markets (with particular regard to underwriting) should be opened fully to foreign firms. After pointing out that the pension and trust advisory market was opened to foreign firms April 1, the Japanese team presented a plan to restructure the interbank brokerage mart to give both foreign and domestic banks greater competitive opportunities.

- Japanese access to foreign financial products - The Americans noted that regulations prevent Japanese savers from taking advantage of instruments offered in offshore markets and prevent foreign firms from offering in Japan innovative foreign-based products, hobbling foreign financial competitors. As specific examples of restrictions on foreign competition Mr. Mulford pointed to the prohibitions on offshore investment accounts, barriers to Merrill Lynch Japan Inc.'s efforts to sell U.S.-based asset-backed money market funds to Japanese investors and MOF's cautious approach to Globex, the Chicago Mercantile Exchange's 24-hour, electronic commodity-futures trading system. MOF countered that tentative approval for domestic use of Globex was given recently and that approval for Merrill Lynch Japan's synthetic security is also likely. The ministry defended some of its caution, however, saying that it cannot shirk its responsibility to assure the soundness of domestic financial markets and to protect the interests of Japanese investors.

- Tax and administrative matters - The American team argued that Tokyo should take a hard look at distorting taxes and problems of administrative transparency in order to bring Japan's financial markets more into line with American and European norms. Mr. Mulford pointed to the withholding tax on Japanese treasury bills, the lack of foreign input into the numerous government financial advisory councils and the lack of transparency in general as significant barriers to greater foreign participation in Japan's financial markets. Mr. Utsumi countered that current Japanese fiscal policy leaves little room for tax reductions and that his ministry is open to foreign complaints.

The American delegation's suggestions did not contain any new points of significance but were far broader in scope than before. Demands for a clear, accelerated implementation schedule reinforced the impression that the executive branch wants to be seen as pushing hard on Tokyo. With several financial

reciprocity bills already introduced on Capitol Hill and congressional ire still unappeased, the administration wants the government of Toshiki Kaifu to act before things get out of hand. Under a provision of the 1988 Omnibus Trade and Competitiveness Act, the White House must report by the end of this year whether Japan and other countries give U.S. financial institutions the same access to their markets that foreign firms receive in the United States. Mr. Mulford underscored his concern in a warning: "As of today, it will not be possible for the U.S. Treasury to give a positive report on the Japanese market." While the Finance Ministry can point rightly to a long list of actions designed to open Japan's financial markets and to help foreign firms compete in these markets, the financial liberalization issues that remain are more complex and have a greater potential for disruption than ever before.

Jon Choy

New Land Taxes May Be Proposed By Autumn

Japan's high land prices, included in the April interim report on the Structural Impediments Initiative talks as a barrier to foreigners wanting to enter the Japanese market, will be at the vortex of tax discussions this year. Since the government's Tax Commission began hearings May 13 on current land taxation policies, scholars and businessmen have joined officials from the Ministries of Construction, International Trade and Industry, Agriculture, Forestry and Fisheries and the National Land Agency in proposing various tax changes to restrain skyrocketing land prices. The wide-ranging discussions cover the low effective rate of land taxes as well as ways to strengthen the special tax on idle land, reevaluate corporate-held land and improve taxation of agricultural land in metropolitan areas. The Construction Ministry and the National Land Agency back steeper taxes on all land, but MITI and MAFF say that any increase in the tax burden must take into account the impact on businesses and farmers. Few expect the Tax Commission to come to any conclusions by the time the final SII report is released in July; the soonest that specific recommendations might be ready is October.

The ruling Liberal Democratic Party also is looking at land problems through its Tax Committee, which held the first meeting on this subject May 10. The Tax Committee, which is regarded as historically having much more power to achieve changes in tax laws than the government's Tax Commission, is scheduled to hold weekly meetings from May 24 in an effort to decide fundamental land taxation policies by late July or early August. Committee members would like to have the details worked out by October so they can submit proposed changes to the Diet by the end of FY 1990.

In an April 13 interview with Nihon Keizai Shimbun, new Tax Committee chairman Masajuro Shiokawa, a former transportation minister, outlined two main goals: effective utilization of idle land and a review of the rigid land-use structures imposed by the Land Lease Law and the House Lease Law, both of which virtually prohibit an owner from evicting a tenant after the expiration of a lease. Mr. Shiokawa noted that even if land taxation policies are overhauled, the supply of land and housing will not increase much without changes in the use of idle land and the legal regime. Therefore, LDP officials plan to hammer out a new land policy prior to deciding on any tax changes.